



# M e m o r a n d u m

To: Panel Members Date: January 26, 2007

From: Ada Carrillo, Acting Executive Director File:

Subject: PROFESSIONAL EMPLOYER ORGANIZATIONS & PAYROLL COMPANIES

This memorandum discusses the Employment Training Panel's (Panel or ETP) policies with respect to funding temporary employment agencies, professional employer organizations (PEO) and motion picture payroll service companies (payroll companies). The primary question is whether this type of funding furthers program goals, such as job security and wage progression. Ultimately, the Panel may consider whether temporary agencies, PEOs and/or payroll companies are eligible employers.

## **Background**

As the economy evolves with new technologies and workplace demands, an employment services industry has emerged nationwide -- with temporary agencies placing workers, and PEOs or payroll companies providing services. Their clients typically range from small to mid-size companies, across industry sectors. The extent of their services and responsibilities are governed in part by statute, and are set forth in a contract.

### *Three Employment Models*

In the past, the Panel has considered proposals to train workers employed by temporary agencies, PEOs and payroll companies -- but has denied them due to concerns about job security, wage progression, and eligibility. However, there appear to be important distinctions between these three employment service models:

- 1) Temporary agencies employ workers and place them with client companies to fill short-term staffing needs. The workers usually have specialized skills in blue-collar job classifications. They may work full- or part-time, for a few days or a few months. They may eventually be hired by the client company, but that is not guaranteed, nor is it typical. Salary and benefits are normally paid and administered by the temporary agency and charged to the client company.

- 2) PEOs provide HR support and perform related administrative services for client companies. Typically, PEOs “hire” the client company’s workers and become the employer of record for tax and insurance purposes. Subsequently, the workers are contractually “leased back,” and both the PEO and client become legally obligated as “co-employers”.

The client company pays the PEO in accordance with the extent of services being provided. For example, HR support may include recruitment, training, counseling and dispute resolution. Other services might include payroll processing, where the PEO must deduct taxes and share of costs for benefit payments, before disbursing paychecks. The company may also contract for accounting, recordkeeping, and benefit administration services (e.g., management of a 401K Plan).

As a co-employer, the PEO may negotiate a client company’s cost of insurance coverage. PEOs are typically able to negotiate a more favorable premium rate based on economies of scale and the actuarial advantage of a larger and more varied risk pool. Coverage may include worker’s compensation, unemployment insurance (UI), and medical insurance (e.g., health coverage under a Health Maintenance Organization).

- 3) Payroll companies are unique to the motion picture production industry. They are similar to PEOs insofar as they also provide an array of employment related services and become the employer of record. However, unlike PEOs, they do not enter into a co-employment relationship with their clients, the motion picture production companies. Instead, by contractual and statutory obligation, they assume all employment responsibilities for the production workers. In addition, payroll companies must negotiate the terms and conditions of employment on behalf of these workers, and must be signatory to the collective bargaining agreement. Payroll companies are also distinct from PEOs insofar as they typically quit business operations at the end of a client’s production cycle.

### *Past Actions*

The Panel’s focus in the past has been on whether temporary workers qualify as eligible participants. In general, training for temporary workers has been denied, based on concerns about job security and wage progression, particularly as regards parity between temporary and other workers employed at the same company. The Panel also had concerns about employer eligibility, with reference to the program’s special funding by the Employment Training Tax (ETT).

Research shows that temporary work has three major characteristics: unpredictable work schedules; low wages and inadequate benefits; and, impermanent employer-employee relationships. Given these issues, in 1997 the Panel enacted a regulation to limit placements with temporary agencies for purposes of retention. (See Attachment 1, California Code of Regulations Section 4427, “Retained In

Employment with a Training Agency”). In 2000, the Panel revisited its regulation, but chose to maintain the status quo. At that time, the Panel did not consider the issue of funding training for workers co-employed by PEOs, in part because this employment model was less prevalent seven years ago.

It should be noted that the Panel has made exceptions to fund multiple employer contractor (MEC) proposals in the entertainment industry, where the payroll company model is pervasive. In recent years, the Panel has approved a couple of training proposals by a MEC to retrain motion picture production workers with a payroll company employer of record. In each instance, the payroll company was also a signatory to the collective bargaining agreement.

### *UI Code Parameters*

Temporary agencies are not eligible to contract with the Panel under Title 22, California Code of Regulations Section 4427, as discussed earlier. But this regulation does not bar ETP from funding training for workers who are co-employed by a PEO and its client company, or who are employed by a payroll company under contract with a motion picture production company.

There is no statutory distinction between an employer and co-employer under the Panel's enabling law at UI Code Section 10200 et seq. Historically, staff has determined employer eligibility, for purposes of both enrollment and retention, based on the California Employer Account Number (CEAN) assigned by EDD to the employer of record.

There is now a statutory distinction between an employer, and an employer of record, in the entertainment industry, under a related provision of the UI Code. As discussed earlier, newly-enacted UI Code Section 679 (SB1428) establishes that a payroll company must: (1) supply workers to a motion picture production company; (2) be a collective bargaining agreement signatory; (3) control wages and pay workers from its own account; and (4) be contractually obligated to pay wages even if not reimbursed by the motion picture production company. UI Code Section 679 also requires a payroll company to report its wage payment history to EDD within 10 days of quitting business.

In summary, ETP has set guidelines to fund training for temporary workers. The Panel may also want to consider specific guidelines where PEOs and payroll companies are involved. The legislative history behind newly-enacted UI Code Section 679 (SB 1428) might be instructive in developing guidelines to fund training for workers who are co-employed by a PEO, and for motion picture production workers who are employed by a payroll company.

**Primary Issues for ETP**

The Panel's enabling legislation provides that ETP-funded training is to be for secure, high-wage jobs that support the California economy and labor market. Thus, the Panel must also consider the following issues related to this legislative mandate, when determining possible funding for trainees who are co-employed by PEOs or employed by payroll companies:

- **Eligibility** -- The company at which a trainee is employed must be an "eligible employer" to qualify for ETP funds. In general, this means the company must be subject to payment of the UI tax and the ETT in California on behalf of each trainee.

When a PEO is the co-employer, the liability may be shared. When a payroll company is the employer, even though liability is not shared pursuant to SB 1428, that does not necessarily mean a payroll company would be the proper contract party for purposes of ETP funding.

- **Job Security and Wage Progression** -- Under the PEO co-employment model, workers have relatively secure jobs. The work takes place at the client company to do the work of the company (e.g., producing "widgets"), but employment services are performed by PEO staff (e.g., hiring, training, negotiating benefits). Job security and wage progression questions arise when considering cases where the client terminates its co-employment contract with the PEO, or vice versa. However, under the payroll company model, a worker's job security, wage progression and continued wage/benefit payments are assured through collective bargaining, even though the duration of each production job may be short-term by nature of the industry.

**Panel Discussion**

Representatives of PEOs, payroll companies and the businesses that use their services have been invited to provide input on these, and related issues, at today's meeting. A list of discussion topics is attached (see Attachment 2).

Following this discussion, the Panel might want to choose one of the following options to clarify funding for PEOs or payroll companies, while maintaining the status quo for temporary employment agencies:

- 1) Make no changes to current requirements.
- 2) Direct staff to draft pilot program guidelines and/or proposed regulations to distinguish PEOs from temporary agencies, and to clarify possible funding parameters for training workers who are co-employed under this model.

- 3) Direct staff to draft pilot program guidelines and/or proposed regulations to distinguish payroll companies from PEOs and temporary agencies, and to clarify possible funding parameters for training motion picture production workers who are employed under this model.
- 4) Continue to review proposals on a case-by-case basis to ensure that program goals such as job security and career mobility are satisfied when a PEO is the co-employer.

Attachments

4427. Retained in Employment with a Temporary Agency.

- (a) The Panel may fund training for employees of a temporary employment agency only as set forth herein. Temporary employment agencies employ both permanent and temporary workers. The permanent worker performs administrative duties for the agency, usually on the agency's premises. The temporary worker provides services to clients of the agency ranging from clerical to professional, usually on the premises of the client.
- (b) Employment retention for purposes of a Panel contract will be permitted with temporary employment agencies only in the following circumstances:
  - (1) As permanent workers of temporary employment agencies being retrained, as long as the business meets all other funding requirement criteria.
  - (2) New hire trainees trained under a contract with a consortium/training agency may be retained in employment with temporary employment agencies as temporary workers with the following limitations:
    - (A) These placements shall be only on an incidental basis. Incidental placements are placements of new hire trainees as temporary workers with temporary agencies that were not originally planned when the contract was approved and which are no more than 10 percent of the total actual number of new hires placed into employment under the contract;
    - (B) These placements are not the intent of the project from inception, meaning temporary employment agencies are not acceptable as core group employers in the contract to substantiate employer demand; and
    - (C) These placements must complete a retention period of 180 consecutive days with the same temporary agency before payment is considered earned.

Authority: Section 10205(l), Unemployment Insurance Code.

Reference: Section 10201(g), Unemployment Insurance Code.

Effective: December 4, 1997

## **Discussion Topics for PEO & Payroll Company Panelists at January 2007 ETP Meeting**

1. Please describe Professional Employer Organizations (PEO) and/or Motion Picture Payroll Services Companies (Payroll Companies) and the range of services/products they provide. How do these models differ from temporary agencies? How common are they in California?
2. What are the reasons a company might contract for the services of a PEO or a Payroll Company?
  - a. What are the advantages/disadvantages for the client company and the PEO or Payroll Company?
  - b. Is there a “standard” contract used between the client company and the PEO or Payroll Company?
3. Based on your experience, describe the nature of the co-employer relationship when the client company contracts with a PEO and/or a Payroll Company.
  - a. What are the shared risks and responsibilities?
  - b. Are the workers temporary or permanent? Are they treated differently than workers where PEOs or Payroll Companies are not involved?
  - c. What happens if the client company terminates its contract with the PEO or Payroll Company, or vice versa? Specifically, what happens to the workers?
4. Are PEOs used more commonly in particular industry sectors, or according to the size of the client company’s business? Why?
5. Do you have any other comments to share with the Panel, regarding PEOs and/or Payroll Companies?